MULTIMEDIA UNIVERSITY

STUDENT ID NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 3, 2015/2016

PPE0045 – PRINCIPLES OF MACROECONOMICS

(Foundation in Management)

30 MAY 2016
9.00 a.m. – 11.00 a.m.
(2 Hours)

INSTRUCTIONS TO STUDENT

1. This question paper consists of **THIRTEEN** pages.
2. Answer **ALL** questions in **Section A** and **B**.
3. The answers for **Section A** should be shaded on the OMR sheet. The answers for **Section B** should be written in the Answer Booklet.

SECTION A: MULTIPLE CHOICE QUESTIONS [40 MARKS]

Instructions: Answer **ALL** questions in this section. Shade the answers on the **OMR** sheet.

1. Nike is an American company which produces sneakers in Thailand. This would be _____.
   A. added to Thailand's GDP but not to U.S. GDP
   B. added to neither U.S. GDP nor Thailand's GDP
   C. counted for both Thailand's GDP and U.S. GDP
   D. counted as part of U.S. GDP since it is a U.S. company

2. Transfer payments _____.
   A. refer to all payments made to households by governments
   B. are made by households to firms in exchange for goods and services
   C. are included in the government expenditure category in gross domestic product (GDP)
   D. refer to payments made by the government that are not made to purchase a good or service

Refer to ***Exhibit 1*** for question no.3.

Items	RM
Net exports of goods and services	50
Government expenditure on goods and services	600
Personal consumption expenditures	1500
Rental income	80
Proprietor's income	160
Employees' compensation	1450
Depreciation	350
Indirect taxes less subsidies	330
Net interest	180
Corporate profits	250
Net income earned from abroad	100

Exhibit 1

3. Based on ***Exhibit 1***, the gross domestic product (GDP) is _____.
   A. RM 1,440
   B. RM 2,120
   C. RM 2,150
   D. RM 2,700

4. All of the following are included in gross domestic product (GDP) **EXCEPT** _____.
   A. services offered by hair dressers
   B. production of hot dogs that last for six months
   C. production that takes place in the underground economy
   D. production of goods that last more than a year, such as bicycles

Continued...

5. How do lower personal income taxes affect aggregate demand?
   A. They increase corporate investment and aggregate demand.
   B. They reduce disposable income, consumption, and aggregate demand.
   C. They increase disposable income, consumption, and aggregate demand.
   D. They increase aggregate supply and thus increase aggregate demand as well.

6. Which of the following actions could be undertaken if the government wants to reduce an inflationary gap?
   A. Reduce taxes and reduce government spending.
   B. Increase taxes and reduce government spending.
   C. Reduce taxes and increase government spending.
   D. Increase taxes and increase government spending.

7. Assuming that Y_d = RM20,000 and C = RM22,000, we would find that the average propensity to save equals _____.
   A. 0.9
   B. 1.1
   C. -0.1
   D. -0.8

Refer to ***Exhibit 2*** for question no.8.

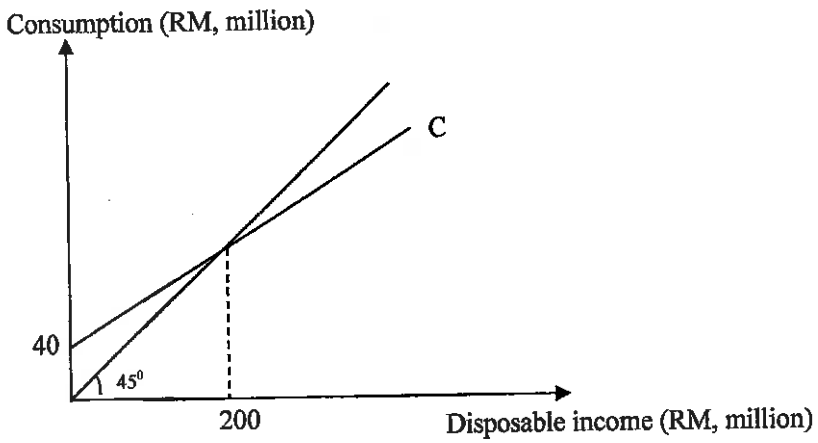

Exhibit 2

8. Based on ***Exhibit 2***, a change in autonomous consumption to 100 would cause the consumption function to _____.
   A. shift up
   B. shift down
   C. become flatter
   D. become steeper

Continued...

9. Mary plans to save RM500 from her salary every month to buy a present for her parent's anniversary next year. Which functions of money best describe the scenario above?
   A. Store of value
   B. Unit of account
   C. Medium of exchange
   D. None of the above

10. Liquidity is defined as _____.
   A. the ease with which a given asset can be converted to a store of value
   B. the ease with which a given asset can be converted to a unit of account
   C. the ease with which a given asset can be converted to a medium of exchange
   D. the ease with which a given asset can be converted to a standard of deferred payment

11. The statement "It helps to maintain confidence and hence the well-being of the country's financial system" illustrates which function of central bank?
   A. Lender of last resort
   B. Control of money supply
   C. Banker for the government
   D. Banker to commercial banks

12. Suppose you withdraw RM100 from your saving account deposit and put it aside without using it. If the required reserve ratio is 10 percent, saving account deposits in the banking system as a whole could decrease up to a maximum of _____.
   A. RM100
   B. RM900
   C. RM1000
   D. RM9000

13. When Mr. Kyle opens a saving account at Public Bank in Melaka, then the bank will _____.
   A. have more deposits and less in reserves
   B. have more reserves and more excess reserves
   C. have more reserves, but excess reserves remain unchanged
   D. have more deposits, but excess reserves remain unchanged

14. An increase in the interest rate _____.
   A. increases the percentage yield of holding money
   B. increases the opportunity cost of holding money
   C. decreases the percentage yield of holding money
   D. decreases the opportunity cost of holding money

Continued...

15. Suppose that Bank Negara Malaysia (BNM) reduces the discount rate, using the money demand and money supply model and assuming everything else is held constant, the equilibrium interest rate should _____.
    A. be zero
    B. not change
    C. be increasing
    D. be decreasing

16. The quantity theory of money implies that the price level will be increasing when the money supply _____.
    A. equals zero
    B. is increasing
    C. is decreasing
    D. equals to one

17. In periods of high inflation, _____.
    A. nobody wants to buy goods and services
    B. low nominal interest rates are likely to result
    C. the purchasing power of money is decreasing
    D. people want to hold on to as much money as possible

18. Which of the following statements is **TRUE**?
    A. All price increases constitute inflation.
    B. The producer price index is the most widely followed measure of inflation.
    C. The consumer price index accounts for customers' substitution away from high priced goods, and therefore has a tendency to underestimate the rate of inflation.
    D. None of the above.

19. The consumer price index increased from 124.0 in year 2014 to 130.7 in year 2015. The economy experienced _____.
    A. inflation of 5.4%
    B. deflation of 6.7%
    C. inflation of 6.7%
    D. deflation of 5.4%

20. Suppose that the inflation rate is higher than expected, which of the following groups is most likely to be adversely affected by this unexpected inflation?
    A. A college student with a fixed interest rate college loan.
    B. A homeowner scheduled to make fixed interest rate mortgage payments.
    C. An individual with a savings account interest rate that adjusts with inflation.
    D. A mortgage company schedule to receive fixed interest rate mortgage payments.

Continued...

21. Marina graduated from Multimedia University two months ago with an undergraduate degree in Finance. She is now looking for a job in the financial sector. She is currently classified as _____.
    A. cyclically unemployed
    B. seasonally unemployed
    C. frictionally unemployed
    D. structurally unemployed

22. If the natural rate of unemployment is 6.0% and the economy has an 8.6% rate of unemployment, then what is the cyclical rate of unemployment?
    A. 2.6%
    B. 6.0%
    C. 14.6%
    D. Cannot be determined

23. Structural unemployment refers to unemployment resulting from _____.
    A. technological change
    B. a recession in the economy
    C. taking the time to find the best job
    D. seasonal decrease in demand for labour

24. To draw a long-run Phillips curve, which one of the following is held constant?
    A. The price level
    B. The rate of inflation
    C. The rate of employment
    D. The natural rate of unemployment

25. According to the theory of comparative advantage, a country should _____.
    A. specialise and export goods with the lowest average cost
    B. specialise and export goods with the lowest production cost
    C. specialise and export goods with the lowest opportunity cost
    D. specialise and export goods with the highest opportunity cost

26. If the slopes of the production possibility frontiers involving sugar and rice in countries A and B are equal, _____.
    A. specialisation does not benefit either country
    B. the opportunity cost of producing rice is less in Country B
    C. the opportunity cost of producing sugar is less in Country A
    D. each country will produce identical quantities of sugar and rice

Continued...

Refer to ***Exhibit 3*** for question no.27. ***Exhibit 3*** displays the production possibilities frontier for two countries.

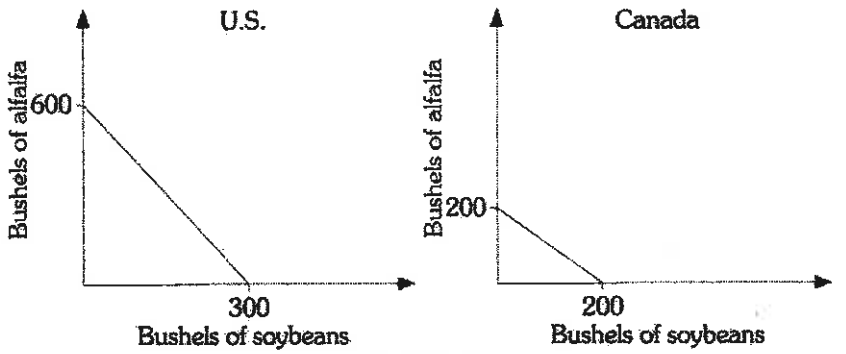

Exhibit 3

27. Based on ***Exhibit 3***, the opportunity cost of producing a bushel of alfalfa in the United States is _____.
    A. the same as that in Canada
    B. half as much as that in Canada
    C. twice as much as that in Canada
    D. four times as much as that in Canada

Refer to ***Exhibit 4*** for question no.28.

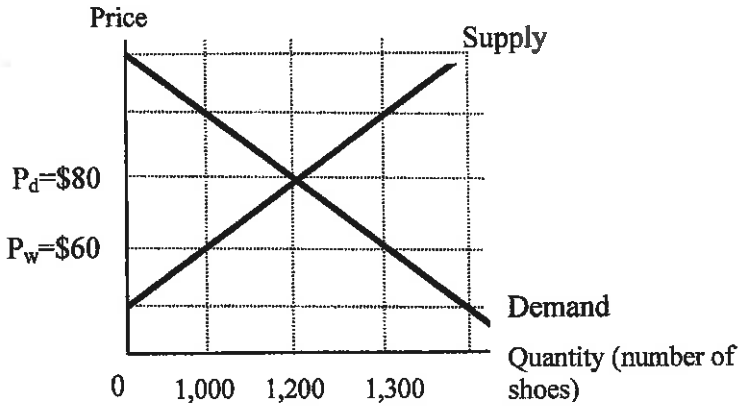

Exhibit 4

28. The domestic price (P_d) of shoes is $80. After trade the price of a pair (P_w) of shoes is $60. After trade this country will import _____.
    A. 100 pairs of shoes
    B. 200 pairs of shoes
    C. 300 pairs of shoes
    D. 1,300 pairs of shoes

Continued...

29. A tariff imposed on imported shoes will cause the domestic price of shoes to _____ and the domestic production of shoes to _____.
    A. increase; increase
    B. increase; decrease
    C. decrease; increase
    D. decrease; decrease

30. Protectionism _____.
    A. is the use of cheap labour to protect firms from paying high wages
    B. is the use of trade barriers to protect domestic firms from foreign competition
    C. refers to reductions in tariffs and other barriers that protect consumers from paying high prices
    D. refers to the use of copyright and trademark laws to protect inventors and artists from losing the rights to their creative efforts

31. Which of the following is **NOT** included in the U.S. current account?
    A. Unilateral transfers
    B. Imports of merchandise
    C. Exports of merchandise
    D. U.S. capital inflow and outflow

32. Which of the following transactions would be recorded as a credit in the U.S. current account?
    A. A Malaysian bank's purchase of Apple Inc.'s stock
    B. A Malaysian consumer's purchase of an Apple computer
    C. An American tourist's payment to Holiday Inn, Malaysia
    D. None of the above

33. Suppose a Japanese bank purchases a U.S. Treasury bond, this transaction would be recorded in the _____.
    A. capital account
    B. current account
    C. unilateral transfers
    D. merchandise trade balance

34. A change in U.S. Treasury holdings of Swiss francs would be recorded in the _____ account.
    A. current
    B. capital
    C. resource
    D. official reserves

35. The part of the balance of payments that adjusts for missing information is called the _____.
    A. error & omissions
    B. statistical discrepancy
    C. provisional adjustment
    D. A and B

Continued...

36. If the dollar to mark exchange rate moves from 1.75 to 1.71 marks per dollar, then the dollar has _____ and the mark has _____.
    A. depreciated, depreciated
    B. depreciated, appreciated
    C. appreciated, depreciated
    D. appreciated, appreciated

37. An increase in U.S. interest rates will cause _____.
    A. a decrease in the supply of U.S. dollars and an increase in the exchange rate
    B. an increase in the supply of U.S. dollars and a decrease in the exchange rate
    C. a decrease in the demand for U.S. dollars and a decrease in the exchange rate
    D. an increase in the demand for U.S. dollars and an increase in the exchange rate

38. Suppose the U.S. price level is 115, the German price level is 172.5, and the French price level is 215. If exchange rate are 1.5 marks/dollar and 2 francs/dollar, then purchasing power parity _____ between Germany and the U.S. and _____ between France and the U.S..
    A. holds, holds
    B. does not hold, holds
    C. holds, does not hold
    D. does not hold, does not hold

39. A balance of payments deficits occurs if _____.
    A. exports exceed imports
    B. the supply of a nation's currency exceeds the demand for the currency at the current exchange rate
    C. the demand for a nation's currency exceeds the supply of the currency at the current exchange rate
    D. the supply of a nation's currency is equal to the demand for the currency at the current exchange rate

40. Which of the following transactions would give rise to a supply of foreign currency from the U.S. perspective?
    A. U.S. imports
    B. A foreigner's purchase of a U.S. asset
    C. U.S. gives financial aid to a foreign country
    D. Income earnings from foreign investments in the U.S.

Continued...

SECTION B: STRUCTURED QUESTIONS [60 MARKS]

Instructions: Answer **ALL** questions in this section. Write your answers in the Answer Booklet.

Question 1

Part A

Assume that the reserve requirement is 20%. Also assume that banks do not hold excess reserves and there is no cash held by the public. Bank Negara Malaysia (BNM) has decided to expand the money supply by RM60 million.

a) If BNM is using open market operations, will it buy or sell bonds?

(1 mark)

b) How much does BNM need to buy or sell in order to expand the money supply by RM60 million?

(2 marks)

c) Suppose that the amount in part (b) is being deposited into a checking account at Bank Z, what is the maximum loan can be made by Bank Z? Show this transaction on Bank Z's balance sheet.

(3.5 marks)

d) What is the impact on the interest rate in the country assuming that everything else is held constant? Will the public increase or reduce the holding of money from this impact?

(2 marks)

e) If RM1 million is being withdrawn from the checking account deposit in part (c) and deposited into the saving account at the same bank, what is the immediate impact of this transfer on M1 and M2?

(1.5 marks)

Part B

a) Suppose the market basket to compute the consumer price index (CPI) consists of 150 units of good X, 175 units of good Y and 50 units of good Z. Year 2013 is used as the based year. Prices of these goods for the years 2013, 2014, and 2015 are given in ***Exhibit 5***.

Good	Amount in market basket	Prices in 2013 (RM)	Prices in 2014 (RM)	Prices in 2015 (RM)
X	200	2.00	2.80	3.60
Y	175	3.00	4.50	4.20
Z	60	4.00	5.00	4.00

Exhibit 5

Based on ***Exhibit 5***, calculate the following.

i. Cost of the market basket in 2013

(1.5 marks)

Continued...

ii. Cost of the market basket in 2014

(1.5 marks)

iii. Cost of the market basket in 2015

(1.5 marks)

iv. CPI in 2013, 2014, and 2015

(1.5 marks)

v. Rate of inflation between 2013 and 2014

(1 mark)

vi. Rate of inflation between 2014 and 2015

(1 mark)

b) Briefly explain the meaning of full employment.

(2 marks)

[TOTAL 20 MARKS]

Question 2

Part A

Consider a world economy consisting of two countries, China and Thailand, which produce handbags and shoes of identical quality. However, the relative costs of producing those two goods differ between the countries. The following ***Exhibit 6*** gives the output per hour of work for the handbags and shoes in China and in Thailand.

Country	*output per hour*	
	Handbags	**Shoes**
China	15	3
Thailand	24	6

Exhibit 6

a) Draw the production possibilities curves for China and Thailand (on two separate diagrams) with handbags depicted on the vertical axis and shoes on the horizontal axis.

(3 marks)

b) If we assume that producers in China and Thailand use the same amount of capital and labour, but difference in labour productivity, which country has an absolute advantage in the production of handbags? Which country has an absolute advantage in shoes production? Briefly explain.

(2 marks)

c) Calculate the opportunity cost of producing handbags and shoes for China and Thailand?

(4 marks)

d) Which country should specialise in the production of handbags? Which country should specialise in the production of shoes? Discuss your answer based on the theory of comparative advantage.

(3 marks)

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Part B

Exhibit 7 shows domestic demand and supply for sugar.

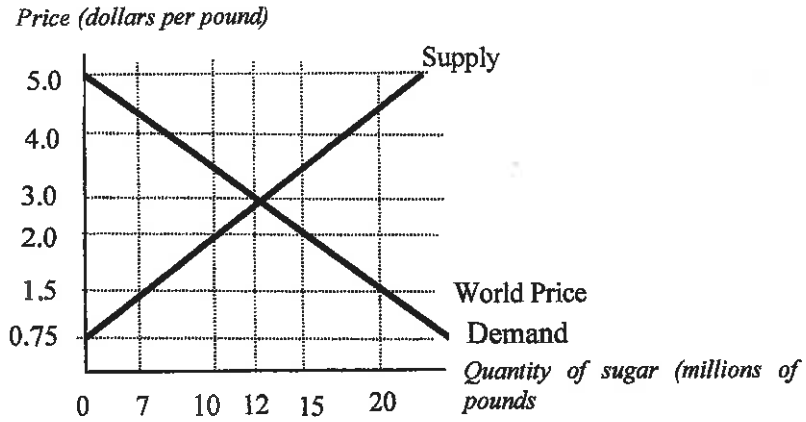

Exhibit 7

a) In the absence of trade, what is the equilibrium price and quantity of sugar?
(1 mark)

b) After trade, what is the price that domestic consumers must now pay and what is the quantity of sugar imported?
(2 marks)

c) Calculate the value of consumer surplus before and after trade.
(2 marks)

d) Calculate the value of producer surplus received by sugar producers before and after trade.
(2 marks)

e) If trade is allowed, who gains and who loses, the consumers or the producers?
(1 mark)

[TOTAL 20 MARKS]

Continued...

Question 3

Part A

Exhibit 8 depicts the international transactions of Malaysia measured in billions of Ringgit Malaysia (RM).

Transactions	RM (billion)
Malaysia exports of goods	20
Malaysia imports of goods	22
Malaysia citizens receive interest income from foreign investments	3.6
Interest income paid on foreign-owned assets in Malaysia	1.4
Foreign travel in Malaysia	1.8
Malaysia citizen's travel expenditure	1.9
Foreign investment in Malaysia	15
Malaysia's investment abroad	20
Malaysia net unilateral transfer	-2.4

Exhibit 8

a) Based on ***Exhibit 8***,
   i. calculate the trade balance. Did Malaysia run a trade deficit or trade surplus?
   (2 marks)
   ii. calculate the service balance.
   (1.5 marks)
   iii. calculate current account balance
   (3 marks)
   iv. calculate capital account balance
   (1.5 marks)

b) The depreciation of ringgit Malaysia makes investment in Malaysia more attractive. As such, recently more and more Singaporeans choose to invest in Malaysia property and their investment amounted to RM6 billion. Which account in the balance of payments is affected by the above? Show the new balance for the account that is affected.
   (2 marks)

Continued...

Part B

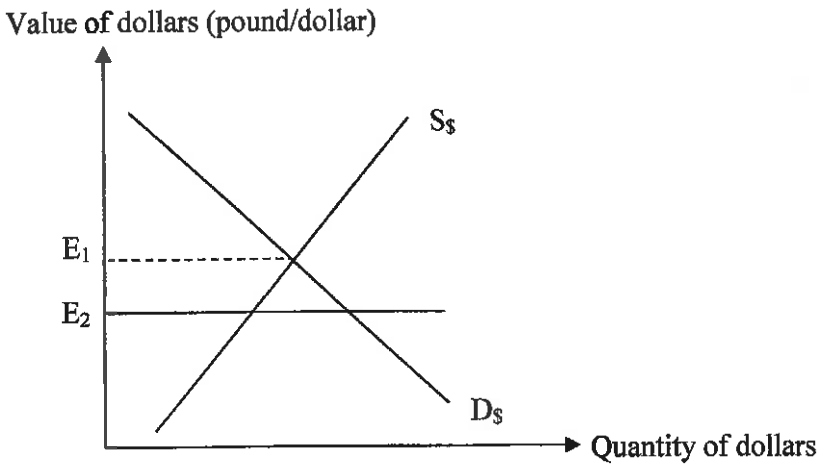

Exhibit 9

a) Explain why the demand curve for dollars is downward sloping.

(2 marks)

b) Under a fixed exchange rate system, at the exchange rate of E_2, is the dollar overvalued or undervalued?

(1 mark)

c) What are the advantages when dollar is undervalued?

(4 marks)

d) What should the central bank of the U.S. do to maintain the value of dollar at the official rate?

(3 marks)

[TOTAL 20 MARKS]

End of Paper